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SUBJECT: CROATIAN CENTRAL BANK MOVES TO LIMIT CREDIT GROWTH

¶1. (SBU) Summary: Increasingly concerned by high credit growth, Croatia's Central Bank moved recently to further limit lending by the country's banks. The new measures aim to limit credit growth to 12 percent annually, a significant drop from the 20 percent plus growth of the last several years. The Bank is concerned that sustained, high credit growth poses an inflation risk for Croatia's import-heavy economy and that it will further worsen the country's balance of payments. The IMF's Zagreb office, although concerned about credit growth, expressed skepticism as to the effectiveness of these measures. End Summary.

¶2. (SBU) Effective January 1, 2007, the Croatian Central Bank introduced new measures aimed at limiting the country's high credit growth. Croatia's 2006 credit growth was 23 percent, further widening total foreign debt from 82.5 percent of GDP to 86 percent. At the same time, the balance of payments deficit grew to 8.1 percent of GDP.

¶3. (SBU) The Bank is concerned that such rapid credit growth, which is playing a significant role in Croatia's GDP growth (estimated at 4.6 percent for 2006), will set off inflation and make the economy increasingly vulnerable to external shocks. Croatia's trade deficit is also a chronic problem that the government has so far been unable to tackle. Partially because of an exchange rate that makes it difficult for domestic products to compete, Croatia's exports amount to only 47 percent of imports annually.

¶4. (SBU) The new measures limit credit growth to 12 percent annually, or 1 percent per month. Banks must file monthly reports with the Central Bank and any lending over 1 percent triggers a requirement for the banks to buy bills from the Central Bank in the amount of 50 percent of the value of lending over the allowed 1 percent. This requirement is cumulative, so that banks that go over the limit would quickly be required to offset 100 percent of the difference.

¶5. (SBU) The new measures come on top of an existing 55 percent marginal reserve requirement on banks' imports of foreign capital. This measure has been partially successful in slowing the growth of foreign borrowing by banks operating in Croatia. However, as 93 percent of the banking sector is foreign owned, many have managed to find ways around these restrictions, including direct consumer lending from their home offices and leasing arrangements.

¶6. (SBU) The IMF's out-going resident representative, Athanasios Vamvakidis, told EconOff on February 9 that he does not believe the latest measures will achieve their desired effect and could have unintended consequences. In his view, the Central Bank's measures will not reduce lending, which is essentially demand-driven. However, they will succeed in making lending less transparent and therefore increase risk.